FISCAL NOTE

HB 26 - SB 64

FIRST EXTRAORDINARY SESSION

April 14, 1999

SUMMARY OF BILL:

- Imposes the franchise and excise tax on limited liability partnerships, limited liability corporations, sole proprietorships, and any other organization or entity engaged in a for-profit business in Tennessee. The Commissioner of Revenue would be authorized to collect excise and franchise taxes from any business organized for profit regardless of its method of organization, unless such entity has a not-for-profit exemption under the Internal Revenue Code or has a specific exemption under Tennessee law.
- Redefines "business earnings" under the excise tax laws to provide that the corporate owner of a pass-through entity that participates in the management or control of the pass-through entity, directly or indirectly, by virtue of an affiliated corporation, would be deemed to be engaged in the pass-through entity unitary business activity. If a tiered pass-through entity were involved, the ultimate owner of the tiered pass-through entity would be deemed to be the owner of the pass-through entity engaged in business in Tennessee.
- Adds a new provision to present law in which excise tax is imposed. The new provision provides that a corporate owner of a pass-through entity, that either participates in the management or control of the pass-through entity, directly or indirectly, by virtue of an affiliated corporation, would be deemed to own its percentage interest of the assets owned or leased by the pass through entity. If tiered pass-through entities are involved, the ultimate owner would be deemed to be the owner of the pass-through entity engaged in business in Tennessee. Also, if affiliated corporations participate in the management or control of the pass-through entity, the pass-through entity unitary business income would be reported on a combined return by all of the affiliated corporations that are owners of such pass-though entity. The return would reflect the affiliated corporations' combined percentage interest of the operations of the pass-through entity unless the commissioner of revenue consents to an election by each of the affiliated corporations to the filing of separate returns in Tennessee reflecting such corporation's percentage interest of the pass-through entity unitary business income. Also under this bill, if affiliated corporations participate in the management or control of the pass-through entity, each of the affiliated corporations that are owners of such pass-through entity must file combined returns and pay tax on the combined percentage interest of the ownership interest, surplus and undivided profits of the pass-through entity, unless the commissioner consents to an election by each of the affiliated corporations to the filing of separate returns in Tennessee, reflecting each of the affiliated corporation's percentage interest in the ownership interest, surplus and undivided profits.
- Defines "pass-through entity" as a partnership, limited liability company, limited liability partnership and any other unincorporated association on which the owner includes the income, gain and loss of the entity in the owner's federal tax computations.

- Removes the following present exemptions from the sales tax: 1) Agricultural Products. 2) Automobiles sold to members of the armed forces who are stationed in Tennessee. 3) Rentals of films to theaters, and rentals of films, transcripts, and recordings to radio or television stations. 4) Chemicals and supplies used in air or water pollution control facilities. 5) Newspapers. 6) Taxidermy Services. 7) Energy fuels sold to consumers for residential use. 8) Sales of motor vehicles that are not registered or titled in Tennessee. 9) Cooperative direct mail advertising. 10) Sales of boats, motorboats, and other vessels that are not registered and identified in Tennessee. 11) Architects, engineers, landscape architects and interior designers sketches, drawings, and models
- Codifies exemptions from the sales tax for articles manufactured from the produce of Tennessee under Constitution of Tennessee and for applications of the sales tax that would violate the Constitution of the United States.
- Extends the definition of "farm equipment" exemption to include all farm equipment regardless of cost and remove the exemption from the sales tax for all farm equipment.
- Extends the definition of "industrial machinery" to include all remanufactured machinery regardless of cost and remove the exemption from the sales tax for all industrial machinery.
- Extends the entire charge for cleaning and grooming an animal to the sales tax. Under existing law, only 15% of the gross charge for bathing and grooming an animal is subject to the sales tax.
- Removes the exemption from the sales tax for contractors and subcontractors who fabricate, erect, or apply tangible personal property that becomes a component part of a building, and which is not sold by such contractors or subcontractors as a manufactured item.
- Removes the following reduced rates and credits: 1) The reduced rate of 3% on the gross proceeds from the retail sale of manufactured homes. 2) The reduced rate of 4.5% on aviation fuel. 3) The reduced rate of 1.5% on electricity, liquefied gas, coal, wood, and energy fuel used by farmers and nurserymen in the production of crops or food. 4) The tax credit of all but 0.5% of sales and use tax on the sale or use of building materials, machinery, and equipment used in a qualified new or expanded headquarters facility. 5) The reduced rate of 3% on the portion of the sales price of an aircraft exceeding $100,000.
- Removes the sales tax on bread, milk, eggs, baby food, and baby formula.

ESTIMATED FISCAL IMPACT:

Increase State Revenues - Net Impact $1,371,026,000

Increase State Expenditures - Dept. of Revenue
Exceeds $3,000,000 Recurring
Exceeds $2,000,000 One-Time

Increase Local Govt. Revenues - Net Impact $239,135,000

Estimate assumes the following:

- Bill contains no earnings exemption levels for any business entities.
- Partnerships will distribute a significant amount of earnings to partners reducing their net earnings for excise tax purposes significantly.
- Sole proprietorships will pay the 6% excise tax on most net earnings.
- Bill eliminates the use of pass-through entities as a method to evade franchise and excise taxes.
- An increase in state and local government revenues from elimination of sales taxes on most currently exempted items.
- Estimate assumes the sales tax collections from the sale of food to be approximately $408,660,000 (state) and $153,247,500 (local). The percentage of sales tax collections for each essential food item that would be exempt is as follows: Milk 2.69%, Bread 1.76%, Eggs 1.13%, Baby Food 0.64%, and Baby Formula 0.87%.
- The total decrease in revenues resulting from the exemption of sales tax on certain food items is estimated to be approximately $28,974,000 in state revenues and approximately $10,865,000 in local government revenues.
- The total increase in state expenditures is estimated to exceed $5,000,000; of which, approximately $3,000,000 is recurring costs and $2,000,000 is one-time costs for implementation of a new tax structure.

CERTIFICATION:

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.

James A. Davenport

James A. Davenport, Executive Director